Transnationals

Quarterly Newsletter of the United Nations Centre on Transnational Corporations

Annual Meeting . . .

INVESTMENT CLIMATE COMPETITIVE IN 90s

Developing Country Prospects Uncertain

Global competition for foreign capital is likely to be intense in the early 1990s, worried delegates to the sixteenth annual session of the Commission on Transnational Corporations, which met in New York in April.

With foreign capital increasingly looked upon to fulfil a variety of national economic goals, developing countries are vying with each other to attract investors. At the same time, the European Community's 1992 unification programme and the opening up of Eastern Europe present foreign investors with a significantly expanded range of investment options and opportunities. In this more competitive global environment, one region may crowd out another.

Outgoing Chairman of the Commission, Adriaan Gautier, Ministry of Economic Affairs of the Netherlands and Chairman of the OECD Committee on International Investment and Multinational Enterprises (left); current Chairman, Marek Kulczycki, Director in the Ministry for External Economic Relations of the Government of Poland (centre); Peter Hansen, Executive Director, UNCTC (right).

"A new environment is emerging, one in which transnational corporations are being called upon to play a significant role", commented Peter Hansen, Executive Director, UNCTC, in his opening address.

In the last two years, over 20 countries have thrown open their doors to foreign investment. In addition, those developing countries that have traditionally been hosts to transnationals have taken a more positive stance on foreign investment through the 1980s. The pressures of structural adjustment; slow growth and foreign exchange shortfalls; rapid technological change; and the new mind-set that foreign equity financing is better than foreign debt have all contributed to this change. Even countries that have been successful in attracting foreign investment are streamlining policies for greater efficiency.

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Namibia Formulating Investment Code

Now an independent nation, Namibia "welcomes foreign investment and will take active steps to stimulate investor interest," stated the new Government. Among the first steps is to adopt an investment code.

In particular, the Government would welcome investments in agribusiness, petroleum, mining, fisheries and manufacturing. Investment in those areas, the Government hopes, might help relieve the disparity in wealth between the developed urban and the impoverished, isolated rural parts of the country. As Namibian leaders put it, there is a "first world" and a "third world" in the same country. While the Government is conscious that in the past investments by transnationals in the Namibian economy have had mixed benefits, its policies are informed by a spirit of reconciliation and co-operation with the private sector.

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But the new laws by themselves will not be sufficient to establish the appropriate legal and economic environment for the promotion of foreign investment.

A Two-tier Investment System?

Developing countries are finding it increasingly difficult to attract foreign direct investment, Latin American, African, and Asian delegates said. Despite following all the precepts — liberalization, incentives, the removal of price and capital controls, and a host of other deregulations and procedural simplifications — reaction from foreign investors has been negligible so far.

European unification and Eastern Europe's opening could further marginalize developing countries position in global investment flows.

What seems to be emerging, according to Graciana del Castillo, the Uruguayan delegate to the Commission, is a two-tier foreign investment system among developing countries. Over half of new inflows to developing countries have gone to the South-East Asian newly industrializing countries, while investment in Latin America and other regions is dropping. It looks as if poorer countries will find it more difficult to attract foreign capital while richer countries will get a growing share of the investment pie.

The European single market could further marginalize the developing countries' position in global investment flows, delegates remarked. In the last five years, the Community's share of world inflows has more than doubled, at the same time that the developing countries' share has dropped.

Added to this, the opening of Eastern Europe and the Soviet Union might have significant investment diverting effects. Lawrence McQuade, Vice Chairman, Prudential Mutual Fund Management Inc. and an Expert Adviser to the Commission representing business, remarked, "While a direct investment decision between a developed country and a least developed country is not necessarily an either/or choice, some degree of either/or is likely to arise as the Eastern European countries re-enter world markets".

This concern should not be exaggerated cautioned Nikolai Zaitsev, a Soviet academic and Expert Adviser to the Commission. There are various practical and logistical impediments that limit the immediate scope for foreign direct investment in the Eastern European economies.

Despite liberalization, incentives, the removal of controls and other deregulations in developing countries, reaction from foreign investors has been negligible so far.

Country Assessment Studies

The Commission requested a report for next year's meeting containing concrete proposals on ways of promoting foreign direct investment in developing countries. The Commission also sanctioned the preparation of country assessment studies on the role of investment policy and incentives in attracting transnationals and in stimulating the transfer of investment capital, technology and skills. ■

The New "Open-Door" Countries

While global attention has focused on Eastern Europe and the Soviet Union, as dramatic is the recent opening of 11 developing countries previously closed to foreign capital.

Africa	Asia
Angola	Afghanistan
Ethiopia	Democratic People's Republic of Korea
Guinea	Lao People's Democratic Republic
Madagascar	Mongolia
Mozambique	Myanmar (formerly Burma)
	Viet Nam

New Delhi Roundtable: India Need Not Fear Foreign Investment

Opening the roundtable: Madhu Dandavate, Minister of Finance, and Peter Hansen, Executive Director, UNCTC.

"Our industry has matured enough so as to make us feel more confident towards foreign direct investment", India's Minister for Industry, Mr. Ajit Singh, said at a high-level UNCTC investment roundtable in New Delhi in March. His words mirrored the growing feeling both in India and abroad that the Indian economy is now strong enough to be more open to the rest of the world, to international competition, and to transnationals.

Not just that: India could quickly become a leading global economic player, said chief executives of major transnationals participating in the roundtable. With the third largest economy in Asia and the eleventh largest in the world; a well developed infrastructure and natural resources; a $40 billion stock market, larger than that of all the Asian "tigers" and many other emerging markets; the third largest global pool of engineers and scientists; and a highly sophisticated managerial and business class, India has all the potential. But, they said, the country will have to rethink its policy towards foreign direct investment.

India could quickly become a leading global economic player said transnational chief executives.

The two-day "Roundtable on Foreign Direct Investment in India" brought together chief executive officers of major transnationals, senior officials from the Indian Government and chief executives from the Indian private sector and financial institutions to exchange views and expectations about the climate for foreign capital in India. The Ministers of Finance and Industry also attended. The roundtable was organized jointly by UNCTC with the three leading Indian chambers of commerce and the Ministry of Finance.

"The world economy is increasingly being driven by investment, not trade", commented Peter Hansen, Executive Director of UNCTC. "Over 70 per cent of world trade and most technological innovation is now generated by transnationals. International marketing and distribution are also largely carried out through transnationals. India may be left behind technologically and the competitive gap increase, if the country does not integrate more into the world system."

Low Inflows: A Perceptions Problem

Between 1981-87, while Malaysia received a total of $1.28 billion in foreign direct investment, Thailand $3.87 billion, and Indonesia $9.5 billion, India received just $0.5 billion. China received $9.6 billion in 1985 and 1986 alone. Moreover, despite some easing of investment procedures, inflows to India dropped by almost $60 million in 1989.

One reason for the low inflows is that since independence India's economic policy has favoured

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New Delhi Roundtable

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building an indigenous industrial base by minimizing reliance or exposure to foreign investment or competition. Investment policy has been discretionary, with approvals to foreign investors being granted on a case-by-case basis after many months of consideration. Foreign holdings are limited to 40 per cent. Only in export-oriented units is 100 per cent foreign ownership permitted.

Bruno Rubess, Corporate Executive Director, Volkswagen (Federal Republic of Germany).

But the problem is also one of perceptions, said the foreign chief executives. "Appearances are everything", explained Bruno Rubess, Corporate Executive Director, Volkswagen, which has for years tried to obtain permission to produce cars in India. Differing pronouncements by members of the Cabinet, circuitous and arbitrary approval procedures, statements in the press, and lack of clarity in investment policy give investors the impression that they are not really wanted in India. Whether founded or not, it is this perception that determines where foreign investors take their money.

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Need for a Clear Policy

If India is to attract investment, the Government must put in place a transparent and consistent policy on investments and a simplified set of regulations, urged both foreign and Indian chief executives. Though India has so often reiterated its desire for high-tech investment, nowhere is there a clear definition of the term or a list of relevant sectors and projects, remarked one Indian executive. Neither is there a single, comprehensive investment code, Indian executives repeatedly pointed out to Government participants.

"We need to know in which, say, five or six sectors India wants foreign investors and what specific needs it wants fulfilled", stressed Vijaya Rao, Vice President, AT&T. Specific guidelines would aid investors in making specific proposals and simplify the approval process.

Approvals must be radically speeded up. With technologies becoming obsolete at an accelerating rate, the average commercial life of a new technology is now three years. In India, approvals can take up to two years.

Helmut Maucher. President, Nestlé (Switzerland).

Indian chief executives: (from left to right) Rajive Kaul, Managing Director, NICCO (insulated cables); Tarun Das, Director General, Confederation of Engineering Industries, a leading Indian chamber of commerce; U.V. Rao, Managing Director and CEO, Larsen and Toubro (heavy machinery); Vinay Bharat Ram, Managing Director, DCM (textiles).

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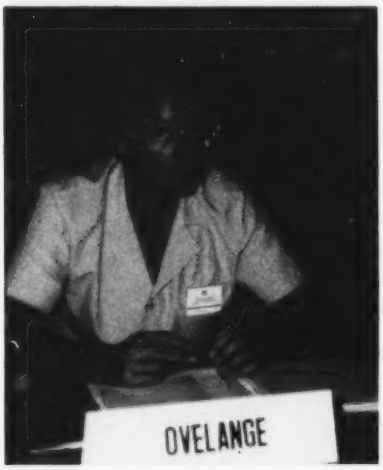
Fielding questions, Ajit Singh, Minister for Industry.

Both Indian and foreign participants repeatedly urged that the 40 per cent limit on foreign equity holding imposed by the Government be revised upward to 50 per cent. While the company will remain "Indian", it has the advantage of being treated as equity participation by the foreign parent rather than as portfolio investment. "Let the partners decide their shares. The party which has the biggest say — the Government of India — has absolutely no stake in the equity", said U.V. Rao, Managing Director and Chief Executive Officer, Larsen and Toubro (India).

changing a few things. "There must be a basic political decision to join global competition and modernize India's industrial sector", said Mainrad Seilz, Ambassador of the Federal Republic of Germany to India.

For a start, India must be prepared to spend more on technology. Through the 1980s, India paid an annual sum of about $280 million for technology imports. Brazil paid over $2 billion.

"We are paying too little", argued former Indian official and UNCTC consultant, Rana Singh.



Ove Lange, Vice-President, Bull International (France).

India should raise the existing 5 per cent royalty limit on imported technologies. Global payments for new technologies are much higher.

Pay More for Technology

An effective opening to foreign direct investment cannot, however, be accomplished by just

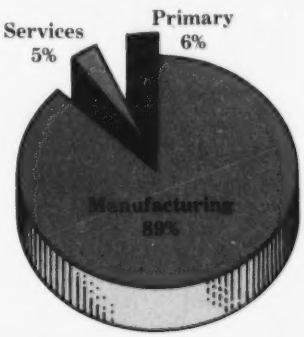
"While technology payments as a percentage of the value of capital goods imports have generally gone up in recent years, in India they have gone down."

India should raise the existing 5 per cent royalty limit on imported technologies, he said. Though the limit exists to protect foreign exchange reserves, global payments for new technologies, particularly in microelectronics and informatics, have tended to be much higher than 5 per cent.

"India must not be obsessed with manufactures alone", said Ove Lange, Vice President of the French computer company, Bull International. In the computer industry worldwide, over half of all export earnings come from soft-

Foreign Investment in India

(Sectoral stocks, 1986)



ware development or exports, not from the sale of goods. Yet the Indian Government, in granting a tax holiday to export-oriented units, only included commodity and disk makers.

What route India will take remains to be seen. The new Government has just issued a revised investment policy. But, as reiterated in the roundtable by many Indian private sector participants, experience shows that Indian products can effectively compete with foreign ones on the domestic market. Should they not, with new technologies from transnationals, compete abroad too? ■

Investment Code

(Continued from page 1)

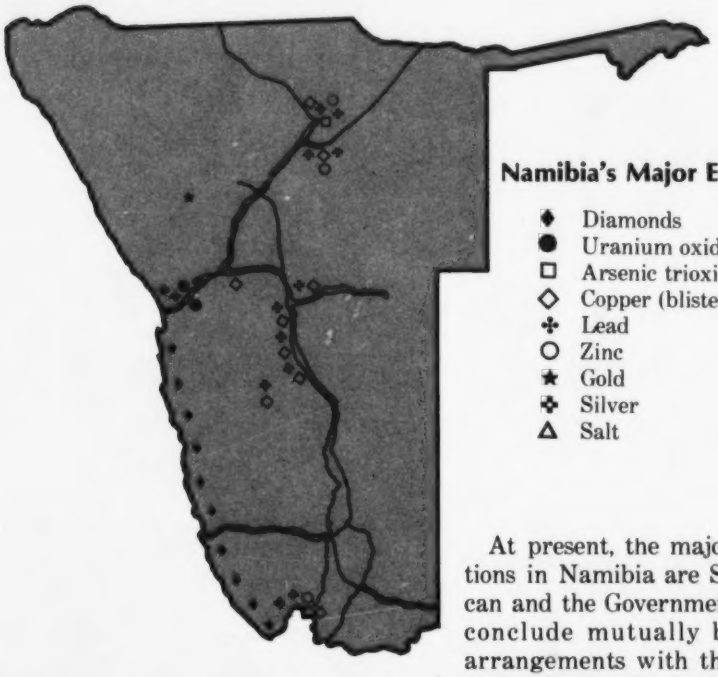
Namibia's constitution protects private property. The code will not restrict business. "Where an activity would be open to Namibian private sector investment, it will be open to foreign investment."

The code will also not require foreign investors to offer an equity stake either to the State or to the local private sector.

However, the code will extend special guarantees and incentives to investors who agree to conform to certain development criteria.

tial of 1.4 to 1.5 million tons of fish (catch) annually, Namibia is among the world's important fishing nations. Further, the country boasts considerable potential in livestock and tourism, among other sectors.

The new code promises to give private enterprise and foreign investment an important role.



The participation of transnationals in Namibia's economy should be viewed in the context of the country's vast potential. Namibia is a mining giant which in 1987 produced more than 1 million carats of diamonds and well over 4,000 tons of uranium oxide. So extensive is its range of minerals, it is difficult to point out one not produced. It is widely believed that Namibia also has hydrocarbon resources. With an estimated potential of 1.4 to 1.5 million tons of fish (catch) annually, Namibia is among the world's important fishing nations. Further, the country boasts considerable potential in livestock and tourism, among other sectors.

At present, the major corporations in Namibia are South African and the Government hopes to conclude mutually beneficial arrangements with those transnationals already in the country. Bilateral donors and international organizations have moved quickly to assist independent Namibia.

Among the first organizations to receive requests for assistance was UNCTC, which is currently helping to formulate the new investment code. UNCTC is also organizing a training workshop for Namibian officials in the evaluation and negotiation of foreign investment projects. ■

Flexible Manufacturing: Productivity via Soft Technology

International competitiveness is propelling the spread of new manufacturing practices in global production. These soft technologies have yielded significant productivity gains, while maintaining production in the developed countries.

The changing fortunes of Japanese and US industry since the mid-1970s have spawned global debate on international competitiveness. In the largest industry, US auto producers lost 20 per cent of their internal market to Japanese imports in the short space of eight years. Similar losses of market share occurred in other industries in a number of Western European countries as well.

In response, US and European firms launched a massive wave of investment in new technology ($80 billion in the auto industry alone in five years). This did not stem the assault, however, as Japanese superiority was not in process technology but in soft technology: new approaches to production organization and management. The innovative practices pioneered by Japan are now widely accepted in the auto industry to represent the best-practice standards that must be emulated in order to be competitive.

Flexible Manufacturing

Mass production has been the dominant mode of manufacturing for more than 100 years. It achieves cost reduction via fixed investments in dedicated manufacturing equipment geared to large production runs of basically similar products. Large inventories are needed to keep the line

running at any cost, and there is little flexibility and innovation in product design or assembly due to the high costs of scrapping and changeover.

In contrast, the main elements of flexible manufacturing are:

- Machinery redesign and training of production line workers to do quick changeovers, thus minimizing downtime.
- Production layouts and changes in the use and management of machines to smooth flowthrough of smaller lot sizes.
- Inventory reduction to a minimum "just-in-time" level rather than being stocked "just in case", so that different product types can be accommodated in much smaller volumes without running up enormous carrying costs.
- Highest quality components, whether from suppliers or from in-house sources, specified for zero defects to maintain the smooth flow of production in the absence of inventories.
- Total quality control, including preventive maintenance practices and the vesting of such responsibility in production line workers.
- Few skill and craft demarcations among workers, who are trained to be multi-skilled and paid according to their skill level and the quality of their work.

Flexible manufacturing applies automation technologies (computers, machine tools, robots, control and transfer systems) in all phases of production. Since automation technologies share a common language, the various phases can be orchestrated together — thanks to organizational innovations of the type listed above — to allow much higher levels of integrated, systematic automation. Systems-level integration provides flexibility, which in turn yields gains in efficiency by attaining scale economies at lower output levels than those realized in mass production.

On average, successful use of flexible manufacturing has led to reductions in manufacturing costs of 20 to 40 per cent, in lead times of 50 to 75 per cent, in inventory of 30 to 60 per cent and in labour power of 20 to 50 per cent.

Industrial Paradigms

Crafts were dominant in Europe in the early 1800s.

Mass production emerged in the United States in the mid-1800s in response to a shortage of skilled labour and to better compete with European craft production.

Flexible manufacturing evolved in Japan in the 1950s. It has 3 elements: automation, new practices and supplier networks.

Flexible manufacturing reduces manufacturing costs by upto 40 per cent and labour power by upto 50 per cent.

Supplier Relations

More systemic organizational links between suppliers and producers is one outgrowth of the new best practices. Before, buyers multi-sourced component purchases to drive down the price and reduce the risks of supply disruption. Quality, delivery time and technology were secondary factors. Contracts were short term and frequently shifted from supplier to supplier because of fractional price reductions. All of these elements created the ideal opportunity for developing countries to serve as sources of supply.

Now, however, new forms of buyer-supplier relationship are emerging. Under the just-in-time system, quality and reliability are key determinants of supplier selection. Contractual relationships are shifting to single-sourcing. Plants have to be located in geographically close proximity to allow delivery of components as frequently as two to four times a day, compared to the weekly or monthly deliveries previously required.

Sourcing activities by transnationals into lower-cost countries have been affected. In 1985, for example, both European and North American Philips relocated television chassis assembly to domestic sites and RCA moved assembly of its surveillance camera to Pennsylvania from Taiwan, Province of China instead of relocating to a cheaper site in Asia. IBM, Apple and Hewlett-Packard have built automated plants and are choosing to manufacture more of their new products at home. In the electronics sector at least, reliance on offshore sourcing could be a losing strategy for developing countries. ■

The Emergence of New Approaches to Best-practice Manufacturing. UNCTC Current Study No. 12. Available in September 1990. Copies may be obtained from the United Nations, Sales Section, New York or Geneva.

Will Developing Countries Benefit from Services Liberalization?

After more than three years of negotiations, a multilateral agreement on trade in services may be reached by the end of 1990. Developing countries may extract significant benefits from liberalization, according to a recent joint publication of the World Bank and UNCTC.

Contrary to widespread skepticism, developing countries have comparative advantages in certain aspects of air transport, banking, insurance, tourism, shipping, construction, telecommunications and such professional services as software development and health care.

Remote data processing, such as keypunching for foreign customers, is well established in Barbados and the Philippines. Software development is a rapidly expanding export industry for India. Mexico, Singapore and Thailand are among the top 20 income earners in international tourism. Construction firms from the Republic of Korea, Brazil, China and Yugoslavia are among the 250 largest transnationals in the world. Employment abroad is an important source of foreign exchange for many developing countries.

However, on the whole, comparative advantage in services rests with industrial countries because of their substantial resources in skills, technology, finance and management. Even in activities where developing countries have comparative advantage, industrial countries are better situated to avail of liberalization. Thus, while trade liberalization is inherently good for all countries on efficiency grounds, the goal of increasing supplier participation by developing countries — the so-called development objective — would likely remain elusive.

Liberalization of the services sector may yield greater efficiency gains and dynamic growth opportunities than might be expected on the basis of experience with the goods sector. Improved services, particularly banking, insurance and telecommunications, can foster new projects in the manufacturing sector.

Whether individual developing countries realize gains from liberalization depends on how well the negotiating process expands their export opportunities, encourages the transfer of skills and technology and allows a gradual absorption of the adjustment strains that expansion of trade is likely to entail. ■

Transacting Services

Factor flows (capital and labour) and trade (cross-border transactions) are essential for producing a free world market in services. Unlike goods, services are not tangible or transportable but:

Data flows permit long-distance service transactions between producer and consumer, e.g., banking.

Travel permits movement of consumers (e.g., students, tourists) or producers (e.g., architects, lawyers, cooks, labourers) to transact a service.

Foreign investment permits producers (e.g., banks, hotels) to establish branches or subsidiaries in the host country in order to provide a service.

The Uruguayan Round: Services in the World Economy. A World Bank/UNCTC publication. April — Price $18.95. The book comprises 21 chapters examining conceptual issues, services industries and country experiences.

The United Nations Centre on Transnational Corporations is an autonomous body within the United Nations Secretariat. Under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council, the Centre seeks to further understanding of the nature of transnational corporations; to secure effective international agreements; and to strengthen the negotiating capacity of host countries, in particular the developing countries.

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